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CARRY-BACK OF UNUSED EXCESS PROFITS CREDIT AND NET LOSS

BY LESTER B. ORFIELD*

The problems with which this article will deal concern the carry-back of the unused excess profits credit and the net loss by an affiliated group of corporations whose membership has changed during the years involved through the merger of one of the group into another of its members. The years assumed to be involved are 1943, 1944, and 1945. Concisely stated, the problems are whether, assuming that a consolidated return was filed for the group for 1943, the parent company may carry back a possible unused excess profits credit and net loss of its own for the taxable year 1945 to the year 1943 (a) if separate returns were filed by it and the other group members for 1944 and 1945; (b) if consolidated returns for the group were filed for those years; and (c) if separate returns were filed by it and the other members of the group for 1944, and a consolidated return was filed for the group for 1945. The principal questions that will be discussed are (1) if separate returns are filed for 1944 and 1945, will the parent corporation be entitled to carry back 1945 unused excess profits credit and net losses against the consolidated excess profits tax net income or income tax net income for 1943; (2) if there is a limit on the extent of the carry back, is that limit found in the combined 1943 excess profits tax net income or the income tax net income of the parent corporation, or of the parent and the subsidiary that was merged with it; (3) if consolidated income and excess profits tax returns are filed for 1944 and 1945, may the 1945 unused excess profits credit or net loss for the group filing

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the returns be carried back to the excess profits and income tax net income of the group for 1943, or to such net income for 1943 after excluding that of the subsidiary which merged with the parent and was not during 1945 a separate member of the group; and (4) a similar question for the case in which separate returns were filed for 1944 and a consolidated return for 1945.

The Governing Law

A question may arise with respect to the deduction of a net loss carried over from a prior year in which the law was different from that in the year the deduction is claimed. The Tax Court has recently held that where a change in law has occurred, the deduction of a net operating loss carry-over is computed under the law in effect in the year the deduction is claimed rather than under the law in effect in the year the net operating loss originated.¹

Separate Returns for 1944 and 1945

The situation first to be considered is that in which separate returns are filed for 1944 and 1945. An examination of the earlier law seems indispensable. Up to the year 1929 the rule developed in a group of decisions was that a carry-over could be applied on a consolidated return for a later year only so far as the corporation which sustained the prior year net loss had income in the succeeding year to absorb the net loss. Each corporation was treated separately for the purpose of the net loss deduction. The courts took the view that an affiliated group of corporations filing a consolidated return was not a "taxpayer" within the meaning of the statute, but merely a "tax-computing unit." The following cases illustrate the rule though in two of them the separate returns were filed in the earlier rather than in the subsequent years, and the consolidated returns were filed in the subsequent rather than the earlier year, thus presenting a converse factual situation.

In the first of these cases, the Woolford Realty Co. and the Piedmont Co. had filed separate returns for 1925 and 1926. The latter had sustained a net loss in both years. The two companies filed a consolidated return for 1927. The Woolford Co. had income in 1927, but the Piedmont Co. had no income in that year. It was held that the net losses of the Piedmont Co. for 1925 and 1926 could not be carried over to 1927 and deducted from the consolidated net income.² In another, it was held that a loss sustained

¹Moore, Inc., (1945) 4 T. C. 404.

²Woolford Realty Co., Inc. v. Rose, (1932) 286 U. S. 319, 52 S. Ct. 568, 76 L. Ed. 1128.

by the parent company in 1924, a separate return year, could be deducted in consolidated returns for 1926 and 1927 only from income of the parent company and not from income of a wholly-owned subsidiary.³ The same principle underlies the decision in *Kaiviki Sugar Co. v. Burnet*⁴ where an affiliated group of corporations filing a consolidated return for one year disclosing a net loss, filed separate returns in the next year. It was held that the amount of the net loss sustained by the affiliated group should be apportioned among the several members of the group which, considered separately, sustained net losses, in proportion to the amount of the net loss sustained by each, and that the part of the net loss thus attributable to each should be applied against its net income for the succeeding taxable year. The reason for this was pointed out by Chief Justice Martin of the District of Columbia Court of Appeals in the following language:

"It is plain beyond dispute that it was not the legislative intent to permit a member of an affiliated group joining a consolidated return to make use of its separate net loss for 1921 as an offset against the net gains of its associate members in that year, thereby reducing the net income of the combined group, and at the same time permit it to make use of such net loss as a deduction in its separate return for the years 1922 and 1923. Such a procedure obviously would result in allowing a double deduction for the net loss of such member of the group, first, as an offset in the consolidated return for 1921; and, second, as a deduction in the subsequent separate return of the member for 1922 and 1923. Therefore appellant's claim for a deduction of its entire net loss for 1921, in computing its income taxes for the years 1922 and 1923, is overruled. *Swift & Co. v. United States* (Ct. Cl.) 38 F. (2d) 365."⁵

Summarizing the law up to 1929, it thus appears that a net loss suffered by one affiliated corporation could not be carried over or back to reduce the consolidated net income of a succeeding or preceding year except to the extent of the separate net income of such corporation in such succeeding or preceding year. Under this view the parent corporation in our problem could carry back its 1945 net operating loss only against its own 1943 income.

It next becomes necessary to inquire whether the present statutes and regulations have changed the earlier rule. The conclusion seems warranted that they have not in the situation now being considered. The carry-back of an unused excess profits credit is

³*Vivaudou, Inc. v. C. of I. R.*, (1935 C.C.A. 2) 78 F. (2d) 192.

⁴(1933 D. C. Ct. of App.) 63 F. (2d) 822, affirming (1930) 21 B. T. A. 997.

⁵At p. 823 of 63 F. (2d) 822.

permitted by Section 710 (c) (3) (A) of the Internal Revenue Code, which provides as follows:

"Unused Excess Profits Credit Carry-Back.—If for any taxable year beginning after December 31, 1941, *the taxpayer* has an unused excess profits credit, such unused excess profits credit shall be an unused excess profits credit carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such unused excess profits credit over the adjusted excess profits net income for the second preceding taxable year computed for such taxable year (i) by determining the unused excess profits credit adjustment without regard to such unused excess profits credit, and (ii) without the deduction of the specific exemption provided in subsection (b)(1)." (Italics supplied.)

The carry-back of an unused net operating loss is permitted by Section 122(b)(1) of the Internal Revenue Code, which provides as follows:

"Net operating loss carry-back. If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss."

The present statutes thus permit "the taxpayer" to take the deduction or credit. To the extent that the former decisions rest on this phraseology, they are still applicable. It should be noted, however, that the present statutes use the words "the taxpayer" only at the very beginning, whereas the earlier statutes again repeated the words with respect to who should take the deduction. Thus it is arguable that a broader group of persons are permitted to take the deduction under the current statutes.⁶ It is, however, more likely that the only possibility of a change in the rule lies in the interpretation of the present consolidated return regulations. If they can be construed to authorize the carry-back by the corporations as a unit even where the change is from consolidated to separate returns, then the larger carry-back may be permitted.

There are now in effect two sets of consolidated return regulations, Regulations 104 relating to income tax returns and Regu-

⁶See, however, 5 Mertens, *The Law of Federal Income Taxation*. (1942) Section 29.11.

lations 110 relating to excess profits tax returns. Section 33.15 of Regulations 110 provides that each member of the affiliated group shall be severally liable for the tax computed on the consolidated adjusted excess profits net income of the group, and that intercompany agreements cannot reduce the liability of any member. Section 33.16 provides that the common parent is to act as agent for the subsidiaries with respect to such matters as correspondence, deficiency letters, and petitions. Section 33.30 provides that the excess profits tax liability of each corporation shall be computed under section 710 upon the consolidated adjusted excess profits net income of the group. The basis of tax computation is found in Section 33.31. Subdivision (a) relates to years prior to 1942 and is not applicable to the problems here involved. Subdivision (b) contains definitions of terms as to years after 1941 and subdivision (c) sets out the method of computation. Section 33.31 (c)(1) provides that the net income of each affiliate is to be computed separately as if a separate return was to be filed, except that intercompany transactions are to be eliminated and the net operating loss deduction is not to be taken. Section 33.31 (c)(2) provides that when a consolidated return is filed the net operating loss as defined in section 122 (a) of the Internal Revenue Code is to be computed for each affiliate as if a separate return were to be filed, except that "the provisions of this section pertaining to determination of net income shall apply." Section 33.31 (c)(3) provides that the consolidated net operating loss deduction may not include as carry-backs attributable to corporations no longer filing consolidated returns an amount exceeding the net income of such corporation included in the consolidated return. This subsection reads as follows:

"(3) In no case . . . shall there be included in the consolidated net operating loss deduction for the taxable year as consolidated net operating loss carry-over under . . . , as the case may be (relating to net operating losses sustained by a corporation in years prior to the first taxable year in respect of which its income is included in the consolidated return) and as consolidated net operating loss carry-backs under . . . (relating to net operating losses sustained by a corporation in years subsequent to the last taxable year in respect of which its income is included in the consolidated return) an amount exceeding in the aggregate the net income of such corporation"

This provision would seem to answer the question with respect to the carry-back if separate returns are filed for 1944 and 1945. The parent company in our case could not carry-back to 1943 an

amount in excess of the amount of its net income which was included in the 1943 consolidated return.

A similar limitation on the carry-back of unused excess profits credit is set forth in Section 33.31 (c)(6), which provides as follows:

"(6) In no case shall there be included in the consolidated unused excess profits credit adjustment for the taxable year . . . as consolidated unused excess profits credit carry-backs under . . . (relating to the unused excess profits credit of a corporation for years subsequent to the last taxable year in respect of which its income is included in the consolidated return), an amount in excess of the portions thereof which could have been availed of by such corporation as unused excess profits credit carry-overs and carry-backs, or an excess profits credit carry-over, if a separate return had been filed for such taxable year, but with its net income computed subject to the provisions of (c) (1) (i) of this section."

Referring to this section it is stated in *Fundamentals of Federal Taxation*, American Bar Association Section of Taxation, (1944) 441-442: "An unused credit which arose in a year for which a separate return was filed by a member of the group may be used by the affiliated group only to the extent to which it could have been availed of in a separate return by such member."

The following other provisions of Section 31 contain language leading to the same conclusion: (b) (47); (c) (11); (e); and (f). With respect to (c) (11) it is stated in *Fundamentals of Federal Taxation*, (1944) 442: "If the group has a consolidated unused credit, the credit is to be apportioned among the members for the purpose of determining the unused credit of any member available for a prior or subsequent year in which separate returns are filed."

Two recent rulings with respect to Section 23.31 (d) (3) of Regulations 104 entitled "net operating loss limitation," which is identical with Section 33.31 (c) (3) of Regulations 110, lead to the same conclusion. It was held in a ruling by the Acting Deputy Commissioner of Internal Revenue, dated December 30, 1943, appearing at Paragraph 6101, C.C.H., that in the case of a corporation which for 1942 is a member of an affiliated group which files consolidated income tax and excess profits tax returns for such year but which filed a separate income tax return for 1941 and in such year sustained a net operating loss, such loss can be carried forward and used in the computation of the consolidated net income of the group for 1942 in an amount not exceeding, in the aggregate, the 1942 income of such corporation. It was further

ruled that if a consolidated excess profits tax return had been filed for 1941, the net operating loss of a member included therein may not be carried over into 1942 for excess profits tax purposes where the 1941 loss served to offset the income of the other members in the consolidated group for such year. The Commissioner stated:

"Thus, for example, corporation A, a member of an affiliated group, filed a separate income tax return for the taxable year 1941 and sustained a net operating loss for the year of \$20,000. For the taxable year 1942, corporation A was included in the consolidated return and for such year had a net operating loss of \$10,000. Since the corporation had no net income included in the consolidated net income, the \$20,000 net operating loss for the prior year in which a separate return was filed could not be included in the consolidated net operating loss deduction carry-over. However, if in the year 1942 corporation A had net income of \$30,000 which was included in the consolidated net income, the net operating loss computed with the exceptions and limitations in section 122 (d) (1), (2), (3), and (4), for the year 1941 for which a separate return was made may be included in the consolidated net operating loss carry-over for income tax purposes.

"In the event a consolidated excess profits tax return had been filed for the taxable year 1941, the net operating loss of a member included therein may not be carried forward into the taxable year 1942, for excess profits tax purposes, inasmuch as the 1941 loss served to offset the income of the other members in the consolidated group for such year."

The second ruling presents a factual situation closer to that in the present assumed case, the earlier tax year involving a consolidated return and the subsequent a separate return. It was held in a ruling by the Deputy Commissioner of Internal Revenue, dated October 28, 1944, appearing at Paragraph 6655, C.C.H. and Paragraph 66,457 P.H., that where a parent corporation sustains a net operating loss and files a separate return in the first succeeding taxable year after the dissolution of its subsidiary, such net operating loss may be carried back to the preceding taxable year, in which a consolidated return was filed, and applied against the consolidated net income, but only to the extent of the net income of the parent included in the computation of the consolidated net income increased by its separate net capital gain.

Citing Section 23.31 (d) (3) of Regulations 104, the Commissioner stated:

"It is held by this office that the case to which you have reference, wherein the parent corporation sustains a net operating loss and files a separate return in the first succeeding taxable year after the subsidiary went out of existence, comes within the pur-

view of the above-quoted regulations. Such net operating loss may be carried back and applied against the consolidated net income only to the extent of the net income of the parent corporation included in the computation of the consolidated net income increased by its separate net capital gain."

With respect to the net losses and the credits of the merged corporation, it would appear that they could not be availed of upon the filing of separate returns.

Consolidated Returns for 1944 and 1945

Up to this point there has been considered the situation where-in separate returns are filed in 1944 and 1945. The situation next to be considered is that in which consolidated returns are filed in 1944 and 1945. It will be recalled that consolidated returns were assumed to have been filed in the prior years, so that it would be a case of consolidated returns following consolidated returns. The absence of any express limitation in the regulations such as was found in the case of separate returns would appear to indicate that if consolidated returns are filed the carry-back is against the entire consolidated net income. On the other hand, the statutes prior to 1929 and the reasoning of the decisions interpreting them would indicate that the carry-back is not necessarily against the entire consolidated net income. The following cases illustrate the earlier rule:

In *Swift & Co. v. United States*⁷ Swift & Co. was the parent corporation of an affiliated group filing consolidated returns in both 1918 and 1919. There were about 60 corporations in the group. The 1919 return showed a consolidated net loss, and the company wished to deduct the 1919 loss from the 1918 consolidated net income. One of the affiliated corporations, Libby, McNeill & Libby, had ceased to be a member of the group on October 12, 1918, by a transaction in which Swift & Co. divested itself of all its holdings of Libby stock, transferring the same to its own stockholders in exchange for its own stock. After this transfer there was not sufficient common ownership of Libby stock to keep Libby within the affiliated group. A large proportion of the 1918 consolidated income was attributable to Libby. In 1919 Swift & Co. acquired the entire capital stock of the Union Meat Co., which then became one of the affiliates. Later on in 1919 the Union Meat Co. was dissolved after sustaining a net loss. The Commissioner contended that the changes in the affiliated group prevented

⁷(1930 Ct. Cl.) 38 F. (2d) 365.

any application of the net loss carry-back under Section 204 (b) of the Revenue Act of 1918, which provided that any taxpayer sustaining a net loss could deduct it from the income of the preceding year. The Court of Claims held that the changes in the affiliated group did not prevent the carry-back of the net loss, but that the amount of the carry-back must be computed separately for each corporation. Each company could carry back the proportion of the consolidated net loss for 1919 which its separate net loss for 1919 bore to the total net losses for 1919 of all the corporations before being offset by 1919 income of the other companies. This amount could be used in the reduction of each corporation's separate net income for 1918. Judge Green stated at 38 F. (2d) 380:

"In 1918 the consolidated net income of all the companies, as shown by this letter, was approximately \$42,000,000, and the consolidated net loss for 1919 was \$29,000,000. The total net loss in 1919, before being offset by income from the other companies, was \$32,000,000. The net loss of the plaintiff which it could use in reduction of its 1918 net income would be $29/32$ of \$23,000,000, or a little less than \$21,000,000. This \$21,000,000 net loss could be used in reduction of the \$22,000,000 net income of the plaintiff and leave a net income of \$1,000,000 for 1918. In the same way the other companies having a net loss in 1919 would have the allowable net loss determined and applied against their respective net incomes for 1918. Of course, where a net loss occurred in 1919 and the corresponding company also had a net loss in 1918, the allowable 1919 net loss would not be used in reduction of the consolidated net income for 1918. And, similarly, no net loss for 1919 should be carried back to 1918 in excess of a particular company's net income for 1918. The excess would go for 1920. Likewise, the allowable net losses of the other companies would be determined and applied in a manner similar to that shown in the example hereinbefore first given, and, from the net loss shown as to all members of the group, the consolidated net income of the group would be determined. The tax would then be computed on a consolidated basis."

He stated at 38 F. (2d) 375:

"The consolidated group, as such, is not a taxpayer but a tax-computing unit, and the corporations which are members of the affiliated group for the year, or became members during the year, lose their separate identity while so affiliated only for the purpose of computation of the tax upon one income and one invested capital which is composed of the income and invested capital of such corporations combined, but, when it comes to the assessment and collection of the tax so computed, it is assessed and collected from the several corporations constituting the affiliated group, in

proportion to the net income properly assignable to each, unless there is an agreement among them as to a different apportionment. An affiliated group as a tax computing unit may, in some respects, be likened unto a partnership under the 1918 and subsequent revenue acts."

He stated at 38 F. (2d) 376:

"We think it cannot fairly be claimed that the reference in section 240 (a) to a 'consolidated return of net income' and to the computation of the tax 'in the first instance as a unit' implies the adoption of a complete economic unit theory, i.e., the obliteration and disregard of corporate structures in the determination of taxable income, and also such modifications of other provisions of the statute as may be necessary to give due effect to the logical consequences of the acceptance of that theory. If it had been the intention of Congress to so modify the general principles laid down in the other provisions of the act, we think that there would be found appropriate qualifying phrases in the act setting forth the modifications which would be required, to give effect to this theory of consolidation. In the enactment of section 240, Congress was simply laying down the principle that where a group of companies constituted a single business unit, the net income, determined in accordance with the general principles of law, should be *combined*, losses being offset against gains, and the *rate of tax* should be determined by the relation between such combined net income and the invested capital of the group as a whole, each corporation being at all times separately recognizable and individually liable for its proportion of the tax according to the net income properly assignable to it."

In *Pilgrim Laundry Co.*⁸ Judge Sternhagen stated at 790:

"In an affiliated group the loss of one member may be used to offset the contemporaneous income of other members in computing the consolidated net income, but no part of its prior losses may be so used, nor may the unused excess of its current loss be carried forward except for its own use."

The opinion by Circuit Judge Learned Hand in *Delaware & Hudson Co. v. Commissioner*⁹ offers one of the most complete explanations of the older theory. He stated that the *Woolford Case*¹⁰ "did not allow the summation of a carried-over loss with a loss in the succeeding year." "There is no such thing as a 'minus income,' and the carried-over loss must be deducted from 'income.'" The 1926 statute "declared that any excess of the carried-over loss which was not absorbed by the income for the second year should be applied to the third year; and since there was no

⁸(1932) 26 B. T. A. 788.

⁹(1933 C.C.A. 2) 65 F. (2d) 292.

¹⁰*Woolford Realty Co., Inc. v. Rose*, (1932) 286 U. S. 319, 52 S. Ct. 568, 76 L. Ed. 1128.

suggestion that it could be used otherwise, it must be so used or not at all. This prohibited its use as an item in the consolidated return of the group. Again, the section allowed the deduction only to a taxpayer, and the group is not a taxpayer; the fixed policy of Congress being to assess separately the income of each year, any one who seeks to mingle the income of two years must show express warrant."

As a practical matter if the above rule were not followed, the taxpayer might buy up a derelict company merely to use its losses. The expressed intent of the statute does not allow a broader carry-over. There is an underlying policy that each year's income be assessed separately. Since modern tax statutes are very detailed and particular there can be very little flexibility of interpretation.

The case of *Taylor-Wharton Iron & Steel Co. v. Commissioner*¹¹ is even clearer than the Swift case since the same affiliates were involved in each year. It was held that net losses in 1924 and 1925 of affiliated corporations making consolidated returns could not be deducted from consolidated net gain in 1926 in determining the 1926 tax. The per curiam opinion of the court was as follows:

"The consolidated income tax return filed by the parent of a group of affiliated corporations disclosed that certain of the affiliates had separately sustained losses which resulted in losses sustained by the group in 1924 and 1925. In 1926, the taxable year, the same affiliates again sustained losses; yet, after deducting them from profits made by other affiliates, the group made a gain. In determining the taxable gain, the petitioning taxpayer made an effort to carry forward as a unit and apply the consolidated net losses in 1924 and 1925 against the consolidated net gain in 1926 without reference to that year's gains or losses of the individual corporate affiliates. The Commissioner disallowed deductions of prior losses from the latter gain. From an order of the United States Board of Tax Appeals affirming his decision, the matter is here on the taxpayer's petition.

"We affirm the decision of the Board of Tax Appeals generally on the line of its own reasoning and particularly on authority of *Woolford Realty Co. v. Rose*, 286 U. S. 319, 52 S. Ct. 568, 76 L. Ed. 1128, which was discussed and relied upon by the Circuit Court of Appeals for the Second Circuit in *Delaware & Hudson Co. v. Commissioner*, 65 F. (2d) 292, and by this court in *Beneficial Loan Society v. Commissioner*, 65 F. (2d) 759. The action of the Supreme Court in denying certiorari in these two cases, 290 U. S. 670, 54 S. Ct. 89, 78 L. Ed. 579 and 290 U. S. 677, 54 S. Ct. 101, 78 L. Ed. 584, while not officially significant, inclines us to the belief that

¹¹(1934 C.C.A. 3) 74 F. (2d) 300.

the two courts properly understood the law of the *Woolford Realty Co. Case* and that this court is correctly applying it now."

In *Wilson & Co. v. United States*¹² Judge Green stated at page 346:

"In the case of *Swift & Co. v. United States*, 38 F. (2d) 365, 69 Ct. Cl. 171, 191, we held that in an affiliated group the individual corporations are the taxpayers, that the group is merely a tax computing unit and not a taxable unit, and that accordingly no basis exists under section 204 of the Revenue Act of 1918 for a group application of a consolidated net loss for 1919 to a consolidated net income for 1918 for the purpose of ascertaining the tax. The Commissioner of Internal Revenue has acquiesced in the rule laid down in *Swift & Co. v. United States*, supra, and it has been approved by the courts. Cf. *Delaware & Hudson Co. v. Commissioner*, 26 B.T.A. 520, affirmed (C.C.A.) 65 F. (2d) 292, *Woolford Realty Co. v. Rose*, 286 U. S. 319, 52 S. Ct. 568, 76 L. Ed. 1128, and *Planters' Cotton Oil Co. v. Hopkins*, 286 U. S. 332, 52 S. Ct. 509, 76 L. Ed. 1135. It follows in cases like the one before us that, where an affiliated company sustained a net loss for 1919, it should be deducted from the individual net income of the same company for 1918, and, if it had no income for that year, there could be no deduction."

To the same effect is the statement of Judge Treanor in *Commissioner v. Trustees of Lumber Inv. Assn.*,¹³ which involved the 1924 and 1926 Acts, that

"Statements by different courts indicate an understanding that the group of affiliates is merely a tax computing unit and not a taxpayer.

It had been unsuccessfully argued to the court that the affiliated organizations constituted a business unit operated as a single business enterprise and owned by substantially identical stockholders, and were in substance and in reality a single business entity, and that, therefore, the corporate forms of the affiliated units should be disregarded and the group assessed as one corporation and the consolidated net loss treated the same as the net loss of a single non-affiliated corporation. The court made the following answers. In the leading net loss case, *New Colonial Ice Co. v. Helvering*,¹⁴ the Supreme Court had said that corporate forms should be disregarded only in exceptional cases. To disregard corporate forms would result in a special deduction not available if the corporate forms are given their usual significance under the provisions of the revenue acts. The corporate entity is treated as

¹²(1936 Ct. Cl.) 15 F. Supp. 332.

¹³(1938 C.C.A. 7) 100 F. (2d) 18.

¹⁴(1934) 292 U. S. 435, 54 S. Ct. 788, 78 L. Ed. 1348.

a thing of substance under the revenue acts and not merely as a matter of form. Deductions are a matter of legislative grace. There must be specific statutory authority to allow such a carry-over. It was stated that "unless authority can be found in specific statutory provisions to carry forward the consolidated net losses of the affiliates for deduction purposes, no such authority exists."

The ruling in the *Swift & Company Case*¹⁵ was affirmed as recently as 1939 in a case involving the 1918 Revenue Act.¹⁶ Judge Green therein stated at pages 121, 122:

"The contention of the plaintiff that the decision of this court in the case of *Swift & Company v. U. S.*, supra, was erroneous is based upon the theory that in computing the net income of a consolidated group of corporations the total of the losses of the separate corporations should be deducted from the total of the income of the several companies; or, as is stated in plaintiff's brief, group losses should be deducted from group income, and in accordance with this theory the plaintiff argues that the consolidated group is the taxpayer. To the contrary, we held in the *Swift & Company Case* that 'the separate corporations are the taxpayers, and the affiliated group is merely a tax computing unit, not a taxable unit.' 38 F. (2d) 374. Following this principle, the court held in effect and showed by examples that losses of one company could be deducted only from the gains of that company and not from the consolidated income of the group regardless of the year for which the deduction was sought to be made. Indeed, we think it obvious that if the separate companies are held to be the taxpayers, their income and losses must be determined separately in order to ascertain the basis for the amount of taxes to be paid by each.

"The opinion in the *Swift & Company Case* was rendered in 1930. Since that time the rules laid down therein have been repeatedly affirmed by various courts and the Board of Tax Appeals and the only dissent was made in a case which was disapproved by the Supreme Court. . . .

"No case submitted to this court was more carefully considered than the *Swift & Company Case* which we are now asked to reverse. Upon reconsideration, its reasoning meets with our entire approval and it is generally considered that its conclusions have become established and settled law. We have considered the committee reports on the bill and find nothing therein to the contrary of the construction we have given the statute. Accordingly, we decline to reverse the case and adhere to its principles."

In the *Woolford Case*¹⁷ Mr. Justice Cardozo had stated that "Only one decision has been cited to us as favoring a different

¹⁵(1930 Ct. Cl.) 38 F. (2d) 365.

¹⁶Federal Export Corporation v. United States, (1939 Ct. Cl.) 25 F. Supp. 109.

¹⁷Woolford Realty Co., Inc. v. Rose, (1932) 286 U. S. 319, 52 S. Ct. 568, 76 L. Ed. 1128.

view. *National Slag Co. v. Commissioner of Internal Revenue*, (C.C.A. 3rd) 47 F. (2d) 846." It seems helpful to look at the reasoning of the court in *National Slag Co. v. Commissioner*¹⁸ as thus set forth in the opinion of Judge Davis at page 847:

"These sections make it perfectly plain that if the taxpayer in the case at bar had been an individual, he would have had the right to deduct the losses for 1922 and 1923 from his 1924 tax return. Does a consolidated return make any difference in view of the fact that one member of the group did not have any net income in 1924 to absorb the losses for 1922 and 1923? The answer depends upon the nature of a consolidated return for affiliated companies. The statute does not intimate that its provisions are inapplicable to affiliated corporations. In view of the fact that Buckland owned both companies before and after incorporation of the slag company, it seems on principle that the provisions of section 206 should apply to the consolidated return of these affiliated companies. The return of these companies should be treated as an economic unit, and not as separable into various component parts, or individual returns. In the case of *Ice Service Co. v. Commissioner*, 30 F. (2d) 230, 231, the Circuit Court of Appeals for the Second Circuit said that the income and invested capital of an affiliated group 'are really the income and capital of a single enterprise, though carried on through the instrumentality of several corporations.' Section 240 (b) of the Revenue Act of 1924 (26 USCA § 993 (b)) provides that, 'in any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them.' Consolidated returns were similarly treated by us in the case of *Flannery & Company v. Commissioner*, (C.C.A.) 42 F. (2d) 11. That one of these instrumentalities forming one of the component parts in the consolidated return was not incorporated until after the losses sought to be deducted were sustained, does not make the provisions on principle inapplicable to the return, for it was in fact the same instrumentality, but acting in 1924 through corporate forms. An almost identical situation was presented in the case of Appeal of *Buckie Printers' Ink Co.*, 19 B. T. A. 943, and the Board in that case sustained the contention which the petitioner makes here. The deductions of the losses here in question, sustained in 1922 and 1923, come directly within the provisions of the statute which are plain, certain and unambiguous. Accordingly the re-determination of the board is reversed, thus making this opinion harmonize with the later decisions of the Board, and the return of the petitioner is approved."

The discussion thus far has considered only the law applicable to 1928 and prior years. The rules prevailing for 1929 and subse-

¹⁸(1931 C.C.A. 3) 47 F. (2d) 846.

quent years to 1933 are set forth in Regulations 75 and 78 as follows:

"Art. 41. *Net Losses.*

"(a) *Consolidated Net Loss for 1932 or Subsequent Taxable Year.*

"A net loss sustained by an affiliated group for 1932 or any subsequent taxable year for which a consolidated return is made or is required shall be allowed, in the same manner, to the same extent, and upon the same conditions as if the group were a single corporation, as a deduction for the succeeding taxable year, (1) in computing the consolidated net income of such group; or (2), if a consolidated return is not made or required, then, in computing the net income of the common parent corporation; or (3), if the common parent becomes a subsidiary in another affiliated group which makes a consolidated return, then in computing the consolidated net income of such other group, but in such case the amount of the net loss will not be allowed in excess of the aggregate basis of the stock of such corporation to the members of the other affiliated group. In no case will any such net loss be allowed in computing the net income of a subsidiary (whether on a separate return or a consolidated return of another affiliated group of which the subsidiary has become a member).

"(b) *Consolidated Net Loss for Taxable Year 1931.*

"A net loss sustained by an affiliated group for 1931 for which a consolidated return was made or was required shall be allowed as a deduction in computing the consolidated net income of the group for 1932 of which the common parent corporation is a member, in the same manner, to the same extent, and upon the same conditions prescribed in paragraph (a) of this article, relating to a consolidated net loss sustained in 1932 or a subsequent taxable year.

"(c) *Net Loss Sustained by Separate Corporation Prior to Consolidated Return Period.*

"A net loss sustained by a corporation for a taxable year prior to the taxable year in respect of which its income is included in the consolidated return of an affiliated group (including any net loss sustained for the taxable year 1931) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corporation; but in no case will any such net loss be allowed as a deduction in excess of the aggregate basis of the stock of such corporation to the members of the group.

"(d) *Taxable Year.*

"Any period of less than 12 months for which either a separate return or a consolidated return is made, under the provisions of article 13, shall be considered as a taxable year."

The first ruling to hold that a change had occurred after 1928 was *Century Circuit, Inc. of Delaware*¹⁹ involving 1930 taxes. In the opinion in that case Judge Arundell stated as follows:

"... Prior to the year 1929 the application of net losses sustained before affiliation was limited to the corporation sustaining them (*Woolford Realty Co. v. Rose*, 286 U. S. 319), and the losses sustained during affiliation were subject to apportionment among members of the group as in *Swift & Co. v. United States*, 38 Fed. (2d) 365. These rules were changed for 1929 and subsequent years by the Revenue Act of 1928 and the respondent's regulations promulgated pursuant to the authority contained in section 141 (b) of that act. Article 41 (c) of Regulation 75 provides in substance that, in so far as the year 1929 is concerned, a net loss sustained prior to affiliation and prior to 1929 shall be allowed in computing income of the group for 1929 to the same extent and upon the same conditions as if the group income were the income of the member which had sustained the loss. This means, as we understand it, that if A and B, being separate corporations in 1927 and 1928, sustained losses in those years and one or both of them realized income in 1929 when they were affiliated, then the prior losses could be applied in full to the 1929 income. . . ."

The change is also referred to with respect to a 1929 tax by Judge Black in *General Machinery Corporation v. Commissioner*²⁰ in which he states that:

"It may be appropriate to point out at this juncture that the net loss carry-over of a corporation in a consolidated return under the 1926 Act and prior acts is different from the way it is treated under the Commissioner's Regulations 75, promulgated under the 1928 Act, applicable to the year 1929 and subsequent years. Under the 1926 Act and prior acts, the net loss of the Niles Tool Works Co. for the years 1927 and 1928 could have been applied only as a deduction against the net income of the same corporation, even though it was joined in a consolidated return with other corporations for the next succeeding two years, and if any such net losses were not absorbed by the net income of the same corporation, no further deduction could be taken by reason of such net losses."

It is likewise referred to by Judge Mellott with respect to a 1931 tax in *Acorn Refining Co. v. Commissioner*²¹ as follows:

"Under the provisions of the revenue acts applicable to the years prior to 1929, the net loss sustained by a corporation in one year could not be carried forward to a subsequent year and deducted in computing the consolidated net income of an affiliated group, this privilege being restricted to the corporation which sus-

¹⁹(1934) 31 B. T. A. 764.

²⁰(1936) 33 B. T. A. 1215.

²¹(1936) 34 B. T. A. 566.

tained the loss. . . . However, under the regulation before us, the affiliated group of corporations is permitted to deduct, in computing net income for 1929 and subsequent years, part of the net loss sustained in a prior year by a corporation which was not then a member of the group."

An opinion by Arthur H. Kent, Acting Assistant General Counsel for the Bureau of Internal Revenue, is to the same effect.²² He stated at pages 238 and 239:

"The cited decisions hold in effect that, under the net loss provisions of the Revenue Acts applicable to 1928 and years prior thereto, the net loss of an affiliated company, to the extent not offset in the current year by the income of other affiliates, may be carried forward as a deduction in computing the net income of that company for the next two succeeding years *and of that company only*. This conclusion was contrary to the regulations and the departmental practice thereunder, which treated the affiliated companies as a single unit for purposes of both net income and net losses. (See article 734 of Regulations 74 and L. O. 1113, C. B. III-2, 36, which guided the Bureau's practice respecting the manner of computing consolidated net loss and its application to other years.) That such computation might produce a consolidated net loss which could be carried forward as a deduction against consolidated net income seems not to have been seriously questioned until the decision in *Swift & Co. v. United States*, supra, wherein the general practice then prevailing in cases where there were no changes in the affiliated group is set forth as follows:

' . . . In other words, what the Commissioner did, before he decided that the decision of the Board of Tax Appeals prevented the deduction of a net loss for 1919 from 1918 income, was to deduct the total of the consolidated net loss for 1919 from the total of the consolidated net income for 1918. . . . '

"In view of this well-established practice prevailing on January 3, 1929, when Regulations 75 were promulgated (the decision in the *Swift & Co. Case*, supra, which first questioned the propriety of such practice, not having been decided until February 17, 1930), it is idle to contend that such regulations anticipated the line of decisions cited herein and changed the prevailing practice to accord therewith. That Article 41 of Regulations 75 adopted the fundamental concepts of a 'consolidated net loss' and of treating an affiliated group as 'a single corporation' from the prevailing practice is clear from the use of like phraseology in Article 41. The fact that Regulations 75 changed some features of the prior practice (for example, the rule of Article 41 (a) 3 confining the application of consolidated net losses to other years to the parent only in cases of changes in the affiliated group) merely confirms this conclusion as to adherence to the fundamentals of the prior practice.

²²(1935) C. B. XIV—2, p. 237.

That is, such changes by Regulations 75 (promulgated pursuant to broad powers granted by Section 141 (b) of the Revenue Act of 1928) were manifestly intended to eliminate inherent weaknesses in the controlling theory upon which the then prevailing practice rested. Thus, the above-mentioned fundamentals of the Bureau position were carried unbroken (except as expressly changed by Regulations 75) into the year 1929 with the force and effect of law after the year 1928. That the rule of the later decisions (cited and discussed above as changing the practice of years prior to 1929) is confined to the years not controlled by Regulations 75 is clear from the statement pertaining to the purpose and force of such regulations in *Woolford Realty Co. v. Rose*. . . .

"The manner and extent of the application of net losses to the income of affiliated groups in succeeding years as developed by the Bureau under the earlier Revenue Acts and adopted by Article 41 of Regulations 75 differ radically from the rule of the above-cited cases which govern years prior to 1929. As pointed out in *Woolford Realty Co. v. Rose*, supra, 'Adherence to the one practice excludes adherence to the other.' "

The state of the law before 1928 and after that date up to 1933 is clearly set forth in the latest judicial decision on the carry-over of net losses in consolidated returns.²³ The court held therein that the regulation requiring that net loss sustained by an affiliated group of corporations for which a consolidated return is made be allowed as if the group were a single corporation required the corporate taxpayer to carry forward the consolidated net losses sustained by the affiliated group for 1927 as an allowable deduction in determining its consolidated net taxable income for 1929 in the same manner as if the affiliated group were a single corporation. It was also held that Congress could validly delegate to the Commissioner the power to make such a regulation, and that the regulation was a valid exercise of the authority conferred on the Commissioner by the Revenue Act of 1928.

Circuit Judge Magruder pointed out at pages 840 and 841 that:

"Since 1918, the revenue acts have permitted affiliated groups of corporations to file consolidated returns. Also from 1921 to 1931 the acts gave taxpayers the benefit of a two-year carry-over of net losses to offset net gains in subsequent years. . . .

"But the 1926 act and its predecessors did not spell out the application to consolidated returns of the two-year carry-over provision for net losses sustained by 'any taxpayer'; nor were the Treasury regulations explicit on the point.

²³*S. Slater & Sons v. White*, (1941 C.C.A. 1) 119 F. (2d) 839, affirming (1940 D. Ct. Mass.) 33 F. Supp. 329.

"It was, therefore, inevitable that much litigation would arise out of situations like that presented in the case at bar. It was eventually settled by the Supreme Court in *Woolford Realty Co. v. Rose*, 1932, 286 U. S. 319, 52 S. Ct. 568, 76 L. Ed. 1128, that an affiliated group could not deduct from its income for any one year a preaffiliation loss of a single member of the affiliated group in excess of the income realized by that particular member during the taxable year in question. Thereafter, various circuit courts of appeals, on the basis of the reasoning in the *Woolford Case*, held that in consolidated returns an individual taxpayer theory should be applied throughout in respect to the two-year carry-over of net losses. That is to say, the net loss of a member of an affiliated group suffered during a given taxable year could be deducted (a) from the consolidated net income of the entire group for the taxable year in which the loss occurred, or (b) from the income during the two subsequent taxable years of the affiliate which suffered the loss. However, where a member of an affiliated group suffered a loss during one taxable year which could not be fully used up as a deduction from the income of its affiliates during that same taxable year, the loss could only be carried over against its own net income during the two subsequent years and could not be applied as a deduction against the income of its affiliates in later taxable years. *Delaware & Hudson Co. v. Commissioner*, 2 Cir., 1933, 65 F. (2d) 292, certiorari denied 290 U. S. 670, 54 S. Ct. 89, 78 L. Ed. 579; *New Castle Leather Co. v. Commissioner*, 2 Cir., 1933, 65 F. (2d) 294; *Beneficial Loan Society v. Commissioner*, 3 Cir., 1933, 65 F. (2d) 759, certiorari denied 290 U. S. 677, 54 S. Ct. 101, 78 L. Ed. 584; *Seiberling Rubber Co. v. Commissioner*, 6 Cir., 1934, 70 F. (2d) 651, certiorari denied 293 U. S. 611, 55 S. Ct. 142, 79 L. Ed. 701; *Helvering v. Post & Sheldon Corp.*, 2 Cir., 1934, 71 F. (2d) 930; *Corco Oil Refining Corp. v. Helvering*, 1934, 63 App. D. C. 309, 72 F. (2d) 177; *Taylor-Wharton Iron & Steel Co. v. Commissioner*, 3 Cir., 1934, 74 F. (2d) 300.

"Therefore, if the Revenue Act of 1928 had wrought no change, the *Woolford Case* and the above-cited cases following it would have required a holding that S. Slater & Sons, Inc., and its affiliated companies had no consolidated net income for 1929 subject to tax. . . ."

It was, however, further stated at pages 843 and 845:

"But the Revenue Act of 1928 did radically alter the picture. . . ."

"We think the Commissioner correctly applied Article 41 of the regulations to the facts of the present case. A consistent adoption of the single-taxable theory, with certain safeguards to prevent tax evasion, seems to be characteristic of subsections (a), (b) and (c) of Article 41, read in their natural and ordinary sense. The single-taxpayer theory has the merit of simplicity, and it

also conforms to business reality. Disregarding corporate forms, the business is a practical unit, which S. Slater & Sons, Inc., might just as well have carried on through branches or departments instead of through wholly-owned subsidiary corporations. In fact, unless the single-taxpayer theory were applied, the non-recognition of gain or loss in inter-company transactions in computing consolidated net income, as provided in Article 31 (a) of Regulations 75, would often work manifest hardship. Cf. *Helvering v. Post & Sheldon Corp.*, 2 Cir., 1934, 71 F. (2d) 930. . . .

"As we see it, the Government's contention does not in any invidious sense involve a 'retroactive redetermination' of consolidated net losses. Section 141 (b) of the Revenue Act of 1928 delegated to the Commissioner power to prescribe regulations legislative in character, within properly defined limits and subject to the standards laid down by Congress. The regulations issued pursuant thereto put into force a new method of accounting which was admittedly a marked departure from the old. In prescribing rules for the computation of taxes for future years (1929 and thereafter), where those taxes were to be affected under the two-year carry-over provision by events taking place during previous taxable years, the Commissioner had discretionary authority to devise a new method of looking at past profits and losses of the affiliated companies. The 'redetermination' which the taxpayer objects to is a matter of extreme simplicity, involving merely a reshuffling of figures which the taxpayer must already have arrived at.

"We have no doubt that § 141 (b) of the Revenue Act of 1928 constitutes a proper delegation of power to the Commissioner, and that Article 41 of Regulations 75 as here interpreted and applied constitutes a proper exercise of the Commissioner's delegated power. See *Woolford Realty Co. v. Rose*, 286 U. S. 319, 330, 331, 52 S. Ct. 568, 76 L. Ed. 1128; *Charles Ilfeld Co. v. Hernandez*, 292 U. S. 62, 65, 54 S. Ct. 596, 78 L. Ed. 1127. As was stated in the Senate committee report from which we have quoted above: 'Frequently, the particular policy is comparatively immaterial, so long as the rule to be applied is known.' That would seem to be the case here. Article 41 will sometimes work to the advantage of the taxpayers and sometimes to their disadvantage; if in a particular case it works to their disadvantage, an affiliated group which files a consolidated return cannot in logic object to a result which follows from a consistent application of the single-taxpayer theory. The problem presented in the case at bar is no longer an important one because in 1933 Congress withdrew the privilege of carry-over of net losses, and in 1934 limited the availability of consolidated returns to railroad corporations."

Although there have been no decisions by the Supreme Court, it would appear that that court would take the same view of the

law from 1929 to 1933. Mr. Justice Cardozo stated in the *Woolford Case*²¹ that:

"The petitioner refers us to the Revenue Act of (May 29) 1928 (45 Stat. at L. 791, 835, chap. 852) and to Treasury Regulations adopted thereunder as supporting its position. These provisions were adopted after the liability for the tax of 1927 had accrued, and they can have little bearing upon the meaning to be given to statutes then in force. The Revenue Act of 1928 (§ 141b) protects against unfair evasions in the making of consolidated returns by increasing the discretionary power of the Commissioner in prescribing regulations. . . ."

Thus far the discussion has involved the law prior to 1928 and the law from 1929 to 1933. Our primary concern, however, is with the law in force during the present world war, particularly for the years 1943, 1944, and 1945. The net loss provisions were repealed by the National Industrial Recovery Act of 1933, Sec. 218 (a). Moreover, the 1934 and subsequent Acts eliminated the consolidated returns provision for income tax purposes, except as to railroad corporations. In 1940 the use of the consolidated return was again extended to a large number of corporations, but only for excess profits tax purposes. The 1942 Act extended the consolidated return privilege, both as to income and excess-profits tax returns, to virtually all corporations. The Revenue Act of 1942 added a two-year carry-back to the two-year carry-forward provided for in the Revenue Act of 1939 and made it applicable not only to operating losses but also to unused excess profits tax credits. The first year to which a carry-back may be taken is 1941.

It is the contention of this article that the present Regulations adopt the "economic unity" theory of consolidated returns, instead of the older theory which regarded each affiliate as a separate taxpayer, sometimes referred to as the "legal" theory of consolidated returns. That is to say, the present theory is the same as that prevailing from 1929 to 1933. This seems also to be the view of Mertens. It is pointed out in 7 A Mertens, *The Law of Federal Income Taxation*, (1943), Sec. 42.146, page 692, note 59:

"Regulations 110, promulgated by the Commissioner under the excess profits consolidated returns provisions, prior to amendment by the 1942 act, follows roughly the pattern first introduced in Regulations 78, covering the income tax liability of affiliated corporations under the 1932 Act."

²¹*Woolford Realty Co., Inc. v. Rose*, (1932) 286 U. S. 319, 52 S. Ct. 568, 76 L. Ed. 1128.

It is also stated by the same author in 7 A Mertens, sec. 42.149, page 700, note 78:

"These regulations are similar in pattern to Regulations 78 under the 1932 Act and later regulations including Regulations 104 presently applicable for income tax purposes."

From this it would seem to follow that when consolidated returns are filed in successive years, the net loss of a company which has been merged may be used as a carry-over or carry-back by the corporation into which it was merged. A failure to perceive the true nature of what happens when consolidated returns are filed in successive years has led to a misleading statement of the law by Maurice Austin.²⁵

The first regulations on consolidated returns were relatively brief and simple. Their history is set forth in *Union Pacific Ry. Co.*²⁶ Regulations No. 41 were imposed with respect to the 1917 excess profits tax. The 1917 statute contained no express provision as to consolidated returns. Article 78 provided as follows:

"When affiliated corporations may be required to make consolidated return. Whenever necessary to more equitably determine the invested capital or taxable income, the Commissioner of Internal Revenue may require corporations classed as affiliated under article 77 to furnish a consolidated return of net income and invested capital. Where such consolidated return is required it may be by any one or more of such corporations or by all of them acting jointly; but if such affiliated corporations, when requested to file such consolidated return, neglect or refuse to do so, the Commissioner of Internal Revenue may cause an examination of the books of all such corporations to be made and a consolidated statement to be made from such examination. In cases where consolidated returns are accepted, the total tax will be computed in the first instance as a unit upon the basis of the consolidated return and will be assessed upon the respective affiliated corporations in such proportions as may be agreed among them. If no such agreement is made the tax will be assessed upon each such corporation in accordance with the net income and invested capital properly assignable to it."

The second set of regulations were more detailed, there being seventeen articles instead of two. Regulations 45 were imposed with respect to the 1918 income tax and excess profits tax. Section 240 of the statute of 1918 authorized the issuance of the regulations. Section 240 (a) provided in part:

"In any case in which a tax is assessed upon the basis of a

²⁵See Maurice Austin, *Observations on Minimizing Excess Profits Taxes*, (1944) 77 *Journal of Accountancy*, 203, 211.

²⁶(1929) 17 B. T. A. 793.

consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each."

Article 631 of Regulations 45 provided in part:

"The provision of the statute requiring affiliated corporations to file consolidated returns is based upon the principle of levying the tax according to the true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation. Where one corporation owns the capital stock of another corporation or other corporations, or where the stock of two or more corporations is owned by the same interests, a situation results which is closely analogous to that of a business maintaining one or more branch establishments. . . . In other cases without a consolidated return excessive taxation might be imposed as a result of purely artificial conditions existing between corporations within a controlled group. See articles 785, 791, 802 and 864-869."

The third set of regulations here considered were still more detailed, there being forty-three articles. Regulations 75 were imposed with respect to the years 1929 and subsequent taxable years under Section 141 (b) of the Revenue Act of 1928. Article 41 seems clearly to contemplate that the consolidated corporations shall be treated as a unit with respect to net losses. Article 41 (a) provides:

"A net loss sustained by an affiliated group for any taxable year (that is, 1929 or any subsequent taxable year) for which a consolidated return is made or is required shall be allowed, in the same manner, to the same extent, and upon the same conditions as if the group were a single corporation, as a deduction (1) in computing the consolidated net income of such group for the succeeding taxable years, or (2) if consolidated returns are not made or required, then in computing the net income of the parent corporation for such years, or (3) if the parent becomes a subsidiary in another affiliated group which makes a consolidated return, then in computing the consolidated net income of such other group for such years. In no case will any such net loss be allowed in computing the net income of a subsidiary (whether on a separate return or a consolidated return of another affiliated group of which the subsidiary has become a member)."

Regulations 78, Article 41 was similar in effect. But the net loss provisions having been repealed as of January 1, 1933, Article 41 was thereafter no longer applicable. An interval of eight years elapsed before similar provisions were again adopted. Moreover from 1934 to 1942 consolidated returns could not be filed save by

railroad corporations. For example there are no net loss provisions in Regulations 89 relating to consolidated returns of affiliated railroad corporations, applicable to years beginning after 1933; the same is true as to Regulations 97 applicable to years beginning after 1935. These regulations correspond closely to Regulations 75 and 78 as to their other provisions, however. There is nothing in them to indicate a return to the views prevailing in the statutes and regulations prior to 1929. It may very reasonably be concluded that if the net loss provisions had been in effect from 1933 to 1940 the theory in effect from 1929 to 1933 would have been continued. No criticism of or dissatisfaction with such theory has been discovered by the writer. No reason has been advanced, realistic or even plausible, for going back to the earlier theory. While revenue may be lost in some years, it will be gained in others. It would seem both logical and sensible that, when net loss provisions were again enacted by Congress, the theory last in effect would be adopted. It seems only rational that present patterns are more closely related to patterns of the immediate rather than the remote past. If the intention was to return to the earlier pattern, the statutes and regulations ought to indicate clearly that such was the intention. There is nothing in the statutes and regulations since 1940 indicating an intention to return to the earlier pattern. There have been no decisions by the Supreme Court, the lower federal courts, the Tax Court, or any other tribunals to the effect that there was an intention to return to the earlier pattern. No writers on taxation have so concluded. There can be only a slight negative inference from the fact that Regulations 104 and 110 contain no sections corresponding to Article 41 of Regulations 75 and 78.

Commenting on I. R. C., sec. 141, as amended in 1942 and 1943 it is stated in 1944 Federal Tax Service, Prentice-Hall, Vol. 2, par. 17, 502-B:

"Theory of consolidated returns.—The basic theory underlying the consolidated return provisions is recognition of the fact that although members of a group of corporations are separate entities they are in reality one and the same business and operated as a unit, as indicated in the following extract from the Senate Finance Committee Report in connection with the 1928 act:

"The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise. Unless the affiliated group as a whole in the conduct of its business enterprise shows net profits, the individuals conducting the business have realized no gain. Failure to recog-

nize the entire business enterprise means drawing technical legal distinctions, as contrasted with the recognition of actual facts. . . . To refuse to recognize this situation and to require for tax purposes the breaking up of a single business into its constituent parts, is just as unreasonable as to require a single corporation to report separately for tax purposes the gains from its sales department, from its manufacturing activities, from its investments, and from each and every one of its agencies. It would be just as unreasonable to demand that an individual engaged in two or more businesses treat each business separately for tax purposes.' "

Examination of Regulations 110, particularly Section 33.31, leads to the conclusion that a unit theory should be applied. The definitions particularly are in line with this view. These are set forth for years beginning prior to 1942 in Section 33.31 (a), especially subdivisions (5) on net operating loss deduction, (6) on carry-over and carry-back of net operating loss, (33) on carry-over of unused excess profits credit and (34) on carry-backs of unused excess profits credit. The comparable provisions for years beginning with 1942 are Section 33.31 (b), especially subdivisions (2) on net operating loss deduction, (3) on carry-overs of net operating loss, (4) on carry-backs of net operating loss, and (46) on unused excess profits credit carry-overs and (47) on unused excess profits credit carry-backs. The provisions as to computations are also in accord with this view. These will be found in Section 33.31 (c) especially subdivisions (3) and (4) on limitations on net operating loss deduction, (5) on net operating loss carry-overs and carry-backs, (6) on limitation on unused excess profits credit adjustment, (7) on unused excess profits credit carry-overs and carry-backs, (11) on unused excess profits credit, and in Section 33.31 (e) on net operating loss deduction after consolidated period, and 33.31 (f) on unused excess profits credit after consolidated return period. Several of these regulations take account of the situation when there is a change from consolidated to separate, or from separate to consolidated returns. By implication where a corporation continues year after year in filing consolidated returns the unit method should be employed. No language in the regulations leads to the contrary view.

Separate Returns in 1944 and Consolidated in 1945

So far we have considered the situation where separate returns are filed for 1944 and 1945, and where consolidated returns are filed for 1944 and 1945. We now turn to the situation where

separate returns are filed for 1944 and consolidated returns for 1945. As in all the problems considered consolidated returns are assumed to have been filed in 1943.

The answer to this problem with respect to unused excess profits credits would seem to be found in Regulations 110, Section 33.31 (f), entitled "Unused Excess Profits Credit After Consolidated Return Period." As to net operating loss deductions the answer would seem to be found in Section 33.31 (e), "Net Operating Loss Deduction After Consolidated Return Period." In both cases the second paragraph of the provision is to be applied, since the first paragraph is concerned with return periods prior to January 1, 1942.

The second paragraph of Section 33.31 (f) provides as follows:

"The consolidated unused excess profits credit of an affiliated group for a consolidated return period beginning after December 31, 1941, shall be used in computing the consolidated unused excess profits credit adjustment notwithstanding that one or more corporations, members of the group in the taxable year in which such unused excess profits credit originates, makes separate returns (or join in a consolidated return made by another affiliated group) for subsequent taxable year (or, in the case of a carry-back computation, for a preceding taxable year), but only to the extent that such consolidated unused excess profits credit is not attributable to such corporations, and such portion of such consolidated unused excess profits credit as is attributable to the several corporations making separate returns (or joining in a consolidated return made by another affiliated group) for a subsequent taxable year (or, in the case of a carry-back computation, for a preceding taxable year) shall be used by such corporations severally as carry-overs, or as carry-backs, in such separate returns, or in such consolidated return of the other affiliated group. Any excess profits credit of a corporation for a year prior to the first taxable year in respect of which its income is included in the consolidated return, if the consolidated year begins after December 31, 1941, shall be used in computing the unused excess profits credit adjustment of such corporation (or the consolidated unused excess profits credit adjustment of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in a consolidated return of another group, but absorbed in the computation of the consolidated unused excess only to the extent that such unused excess profits credit was not absorbed in the computation of the consolidated unused excess profits credit adjustment for the prior consolidated return period."

The effect of this provision on carry-backs is as follows: The consolidated credit is to be used in computing the consolidated

credit adjustment even though a member or members of the group in the taxable year in which the credit originated made separate returns for a preceding taxable year. But it is to be used only to the extent that such credit is not attributable to such members. Such portion of the credit as is attributable to the corporations making separate returns for a preceding taxable year is to be used by such corporations severally as carry-backs in such separate returns. Under the last sentence of the provision any unused credit of a corporation prior to the first taxable year in respect of which its income is included in the consolidated return, is to be used in computing the unused credit adjustment of such corporation for a subsequent taxable year for which it makes a separate return. But it may be used only to the extent that such unused credit was not absorbed in the computation of the consolidated unused credit adjustment for the prior consolidated return period.

The same result would seem to follow as to the carry-back of a net operating loss deduction under Sec. 33.31 (e), the language of which is very similar to Sec. 33.31 (f).

It will be noted that under the last sentence of these provisions, liberal provision is made to allow a broad carry-back, subject to a proper deduction, to a date two years previous, in spite of the change first from separate to consolidated and then from consolidated to separate returns.²⁷ On the other hand, the right to a carry-back set forth at the beginning of such provisions is much more limited. The change from separate to consolidated returns involves the cutting off of substantial rights of the taxpayer.

The theory of the first part of the paragraph is thus in conflict with that of the latter part. The question then arises, which part of this provision governs in the present problem, where consolidated returns are filed first, separate second, and consolidated third. It would appear that it is the latter part, the converse of the present case, which should govern. The first part appears to govern the carry-back situation where separate returns are filed in the first year, separate in the second, and consolidated in the third.

The history of the latter part of the paragraph is illuminating and supports a broad view that breaking the consolidation in 1944 would not destroy the carry-back. The old regulations, Sec. 33.31 (e), before their amendment in 1943 by T. D. 5245, C. B. 1943-1, p. 801, did not expressly permit the separate corporations to use

²⁷See for a full discussion hereof 7 A Mertens, *The Law of Federal Income Taxation* (1943), Sec. 42.629, pp. 122-124.

the unused excess profits arising in 1940 if they filed separate returns in 1942. Neither did they specifically prohibit such use. They provided merely that the excess of the consolidated excess profits credits arising during a *consolidated return period* should belong to the common parent. There was a provision in the unamended regulation on net operating loss deduction containing the following language: "No part of any net operating loss sustained by a corporation prior to a consolidated return period of an affiliated group of which such corporation becomes a subsidiary shall be used in computing the net income of such corporation for any taxable year subsequent to the consolidated return period, but any part of such net operating loss which, except for this restriction, might be so used, shall be treated as having been sustained by the common parent corporation of the group." It is pointed out in 7 A Mertens, *The Law of Federal Income Taxation* (1943) Sec. 42.29, page 123, that it would seem that if it had been the intention to prohibit the separate corporations which filed separate returns in 1940 from using their unused excess profits credits from 1940 if they filed separate returns in 1942, the same language would have been used in the section as to carry-over of excess profits credit as is used in the regulation as to the carry-over of net operating loss after a consolidated return period.

While Section 33.31 (f) is the main governing provision, also significant is Section 33.31 (c) (6). This provision is, in part, as follows:

"In no case shall there be included in the consolidated unused excess profits credit adjustment for the taxable year as consolidated unused excess profits credit carry-overs . . . (relating to the unused excess profits credit of a corporation for years prior to the first taxable year in respect of which its income is included in the consolidated return), and as consolidated unused excess profits carry-backs . . . (relating to the unused excess profits credit of a corporation for years subsequent to the last taxable year in the respect of which its income is included in the consolidated return) an amount in excess of the portions thereof which could have been availed of by such corporation as unused excess profits credit carry-overs and carry-backs, or an excess profits credit carry-over, if a separate return had been filed for such taxable year, but with its net income computed subject to the provisions of (c) (1) (i) of this section."

It is pointed out in *Fundamentals of Federal Taxation*, American Bar Association, Section of Taxation (1944) 441-442, with respect to this provision that an "unused credit which arose in a year for which a separate return was filed by a member of the

group may be used by the affiliated group only to the extent to which it could have been availed of in a separate return by such member."

There is similar language as to limitations on net operating loss deductions in Section 33.31 (c) (3) (4).

Also significant is Section 33.31 (b) (47) defining unused excess profits carry-backs. This provision is as follows:

"The consolidated excess profits credit carry-backs to the taxable year shall consist of:

"(i) The amount of the consolidated unused excess profits credit, if any, for the first succeeding taxable year (to the extent not attributable to those corporations making separate returns in the taxable year) reduced to the extent absorbed as a carry-back by the adjusted excess profits net income, consolidated or separate, as the case may be, for the first preceding taxable year, such adjusted excess profits net income being computed in either case without regard to the specific exception provided in section 710 (b) (1) and with an unused excess profits credit adjustment consolidated or separate, determined without regard to the consolidated unused excess profits credit for the first succeeding taxable year;

"(ii) The amount of the consolidated unused excess profits credit, if any, for the second succeeding taxable year, to the extent not attributable to those corporations making separate returns in the taxable year, and, with respect to any unused excess profits credits of a corporation for taxable years subsequent to the last taxable year in respect of which its income is concluded in the consolidated return;

"(iii) The amount of the unused excess profits credit, if any, of such corporation for the first succeeding taxable year reduced:

(A) By the adjusted excess profits net income, if any, of such corporation for the first preceding taxable year, or

(B) If the income of such corporation is included in the consolidated return for the first preceding taxable year, by the amount of the consolidated adjusted excess profits net income for the first preceding taxable year or the excess of that portion of the consolidated excess profits net income attributable to such corporation over that portion of the consolidated excess profits credit attributable to such corporation, whichever is the lesser, the adjusted excess profits net income for the first preceding taxable year (separate or consolidated, as the case may be) being computed without regard to the specific exception provided in section 710 (b) (1) and with an unused excess profits credit adjustment, as the case may be, for the first preceding taxable year determined without regard to the unused excess profits credit of such corporation for the first succeeding taxable year, and

"(iv) The amount of the unused excess profits credit, if any, of such corporation for the second succeeding taxable year."

There is similar language as to carry-backs of net operating losses in Section 33.31 (b) (4).

The concluding provisions which appear to be applicable are Sections 33.31 (c) (9) on Net Operating Loss and 33.31 (c) (11) on Unused Excess Profits Credit. Their provisions resemble each other very closely. The latter provision is as follows:

"If an affiliated group filing a consolidated return for a taxable year beginning after December 31, 1941, has a consolidated unused excess profits credit for such year, and if there are included as members of such group one or more corporations which made separate returns, either in a preceding taxable year (not including any year beginning prior to January 1, 1941) or in a succeeding taxable year, the portion of such consolidated unused excess profits credit attributable to such corporations severally shall be determined, such portion in the case of any such corporation being determined in an amount bearing the same ratio to the consolidated unused excess profits credit for the taxable year which the excess, if any, of that portion of the consolidated excess profits credit attributable to such corporation over that portion of the consolidated excess profits net income, if any, attributable to such corporation bears to the aggregate of such excesses in the case of the several affiliated corporations having such excesses for the taxable year."

Concerning this provision it is stated in *Fundamentals of Federal Taxation*, American Bar Association (1944) 442:

"If the group has a consolidated unused credit, the credit is to be apportioned among the members for the purpose of determining the unused credit of any member available for a prior or subsequent year in which separate returns are filed."

The Merger Problem

There remains to be considered the question of the effect of a merger of one of the subsidiaries with the parent on the carry-back of a net loss or unused excess profits credit belonging to the subsidiary before such merger. This question may arise whether separate or consolidated returns are filed. If the parent filed a separate return, the problem would be whether it could take advantage of the rights which had belonged to the subsidiary prior to the merger. If consolidated returns are filed, the problem would be whether any weight would be given to the net loss or credit of the subsidiary in connection with the net loss or credit of the parent company. It is the considered opinion of the writer that

in no case of separate returns by the parent company can advantage be taken of any net loss or credit of the subsidiary. The effect of the merger was to destroy any such possibility.

Something like twenty-five decisions ranging over a period from 1925 to 1943 have denied a successor corporation the right to use a predecessor's net loss deduction. These include decisions by the Tax Court, the Federal District and Circuit Courts of Appeal and the United States Supreme Court. The Supreme Court so held in 1934 in *New Colonial Ice Co. v. Helvering*.²⁸ The leading treatise on federal taxation takes the same view.²⁹ The same rule was applied to a dividend carry-over credit in *Marion-Reserve Power Co. v. Commissioner*,³⁰ to a dividend paid credit in *Jones v. Noble Drilling Co.*,³¹ and to an undistributed profit tax dividend restriction credit in *Hughes Tool Co.*³²

Occasionally it has been suggested that the rule is not without exceptions. A court which regarded the general rule in merger cases as well established, held that where the merger is with a mere holding company which owns no property except the stock and obligations of the company which produces the entire income may take a net loss deduction.³³ This decision was largely discredited in *New Colonial Ice Co. v. Helvering*. It has been intimated that where the business and assets are not materially altered, the change in corporate entity may be ignored.³⁴ There has been a dictum that where the merger does not result in a new entity, a net loss deduction may be taken.³⁵ It has been intimated that where an affiliation had existed, a corporation resulting from a merger may claim the losses of one of its members sustained before consolidation.³⁶ In a per curiam opinion without any statement of reasons the court in *Northwest Bancorporation v. Com'r*,³⁷ reversed 33 B. T. A. 160, 170, and allowed the successor corporation following even a consolidation to take a net loss deduction.

²⁸(1934) 292 U. S. 435, 54 S. Ct. 788, 78 L. Ed. 1348.

²⁹5 Mertens, *The Law of Federal Income Taxation*, (1942), Sec. 29.11, pp. 335-336, 338-339.

³⁰(1943) 1 T. C. 513.

³¹(1943 C. C. A. 10) 135 F. (2d) 721.

³²(1943) T. C. Memo. Decisions, par. 43, 540. Reversed in a 2 to 1 decision by C. C. A. 5; 1945 P.H. Federal Tax Service, par. 72, 424.

³³*Industrial Cotton Mills Co. v. Com'r*, (1932 C.C.A. 4) 61 F. (2d) 291.

³⁴*Standard Silica Co. v. Com'r*, (1931) 22 B. T. A. 97; see also the dissenting opinions in *General Finance Co. v. Com'r*, (1935) 32 B. T. A. 946, 956.

³⁵*Pennsylvania Co. for Insurances, etc. v. Com'r*, (1935 C.C.A. 3) 75 F. (2d) 719.

³⁶*Pearson, Rec'r v. U. S.*, (1937 D. C. Tenn.) 20 Am. Fed. Tax. Rep. 1334.

³⁷(1937 C.C.A. 8) 93 F. (2d) 1011.

Several cases have refused to allow the net loss deduction to the successor corporation where the predecessor corporation was incorporated in a different state, the change being then more clearly regarded as one of substance.³⁸ Other cases have thought that a change in the capital and financial structure of the corporation was more significant.³⁹ The two decisions last cited were discredited in *New Colonial Ice Co. v. Helvering*. In general the net loss deduction has been denied even though the successor corporation continued the same business with the same officers and had the same stockholders in the same proportions.⁴⁰

Aside from the prevailing precedents a good argument on the merits can be made for allowing the successor corporation to take the net loss or credit. The courts should not be blinded by the mere form of the law, but regardless of fictions should look at the substance of the transaction involved.⁴¹ Consequently, while they will not permit evasion of the law through technicalities, they will bear in mind the danger that the law may work unreasonable and unnecessary hardship on the taxpayer.⁴² They should therefore take cognizance of the fact that the successor corporation is in reality a mere continuation of the old corporation.⁴³ As recently as 1939 in a bond discount case the United States Supreme Court held that in the case of a merger the corporate personality of the transferor is drowned in that of the transferee, and that the continuing corporation should be allowed to take the discount.⁴⁴ It was stated, however, in *Marion-Reserve Power Co.*⁴⁵ that that case should not be taken as meaning that as a general rule a corporation resulting from a statutory merger is the same taxable entity as the constituent companies. It would appear to be the prevalent theory that a change in corporate entity is something more than a mere matter of form and that in order to give effect to the tax laws

³⁸*The Maytag Co. v. Com'r*, (1929) 17 B. T. A. 182; *General Finance Co. v. Com'r*, (1936 C.C.A. 3) 85 F. (2d) 846.

³⁹*Standard Silica Co. v. Com'r*, (1931) 22 B. T. A. 97; *Pioneer Pole & Shaft Co. v. Com'r*, (1932 C.C.A. 6) 55 F. (2d) 861; *H. H. Miller Industries Co. v. Com'r*, (1932 C.C.A. 6) 61 F. (2d) 412.

⁴⁰*New Colonial Ice Co. v. Helvering*, (1934) 292 U. S. 435, 54 S. Ct. 788, 78 L. Ed. 1348; *Weber Flour Mills Co. v. Com'r*, (1936 C.C.A. 9) 82 F. (2d) 764.

⁴¹*Western Maryland Ry. Co. v. Com'r*, (1929 C.C.A. 4) 33 F. (2d) 695; *Early v. Southgate Corporation*, (1943 C.C.A. 4) 136 F. (2d) 217.

⁴²*New York Cent. R. Co. v. Com'r*, (1935 C.C.A. 2) 79 F. (2d) 247; *Chester N. Weaver Co. v. Com'r*, (1938 C.C.A. 2) 97 F. (2d) 31.

⁴³*Appeal of A. J. Siegel*, (1926) 4 B. T. A. 186; *Industrial Cotton Mills Co. v. Com'r*, (1932 C.C.A. 4) 61 F. (2d) 291.

⁴⁴*Helvering v. Metropolitan Edison Co.*, (1939) 306 U. S. 522, 59 S. Ct. 634, 83 L. Ed. 957.

⁴⁵(1943) 1 T. C. 513, 518.

such a change must be regarded as more than a matter of form. In fact it has been asserted that the successor in a statutory merger or consolidation is never the same entity as the predecessor, and that all cases have so held.⁴⁶

In the case of a consolidation the law is very clear that the successor corporation may not take the net loss deduction. It does not follow logically that the same rule applies in cases of merger. A consolidation results in the creation of a new corporation, while a merger does not. It is much more obvious that the new consolidated corporation is not the same taxpayer as any of the former corporations.⁴⁷ Many cases, however, fail to distinguish between a consolidation and a merger. Occasionally it is stated that it is only where the predecessor and successor corporations are intended to be and are organized as two separate and distinct corporations, that the successor corporation cannot take the net loss or credit of the predecessor.⁴⁸ Consequently, it may take the net loss or credit where the identity of the transferor is preserved.⁴⁹ Moreover it has been stated that the separate identity of corporations may be disregarded in exceptional situations, but the cases do not support the view that a consolidation or a merger involves an exceptional situation.

The remainder of this discussion will consider the various theories relied on for denying the net loss deduction following a merger. It has been asserted that to allow a deduction would open the door to tax evasion by permitting a corporation with taxable income to escape taxation by the simple expedient of acquiring a business which had sustained losses in past years.⁵⁰ It must be obvious, however, that relatively few mergers are devised for that purpose and that it would therefore be very harsh to lay down a rule based on the conduct of a few corporations. The Supreme Court held in *Gregory v. Helvering*⁵¹ that a transaction, transfer or arrangement made primarily for business purposes will be accorded full recognition despite the presence of incidental tax-saving purposes and effects. In *Delaware & Hudson Co. v. Com'r.*⁵² Judge Learned Hand seems to have thought such an argument

⁴⁶*Marion-Reserve Power Co. v. Com'r.*, (1943) 1 T. C. 513, 516.

⁴⁷*National Bank of the Republic v. Com'r.*, (1934) 31 B. T. A. 680; *Penn. Co. for Insurances on Lives, etc. v. Com'r.*, (1935 C.C.A. 3) 75 F. (2d) 719.

⁴⁸*Scruggs-Vandervoort-Barney, Inc.*, (1942) B. T. A. Mem. Dec. par. 42619.

⁴⁹*American Gas & El. Co. v. Com'r.*, (1936 C.C.A. 2) 85 F. (2d) 527; *Early v. Southgate Corp'n.*, (1943 C.C.A. 4) 136 F. (2d) 217.

⁵⁰*Industrial Cotton Mills Co. v. Com'r.*, (1932 C.C.A. 4) 61 F. (2d) 291.

⁵¹(1935) 293 U. S. 465, 55 S. Ct. 266, 79 L. Ed. 596.

⁵²(1933 C.C.A. 2) 65 F. (2d) 292.

merely a makeweight argument. Moreover I. R. C., sec. 129, enacted in 1943, quite adequately puts a stop to the tax avoidance device of buying up corporations having losses or excess profits credits, in order to improve the tax situation of the purchaser.

Against allowing the successor corporation to take a deduction it has also been frequently urged that deductions are a matter of legislative grace and that only as there is a clear statutory provision therefor can any deduction, particularly in a different year, be allowed.⁵³ It has, however, been held in a bond discount case that the successor corporation may take the discount since the regulations do not in terms confine the discount to the predecessor corporation.⁵⁴

Doubtless the basic reason advanced against permitting the successor corporation to take a net loss deduction is that the same taxpayer is not involved.⁵⁵ About fifteen cases have so held in the years from 1929 through 1943. A dissenting opinion in *Standard Silica Co. v. Com'r.*⁵⁶ asserted that the same taxpayer was involved. It should be carefully noted that the present statute, I. R. C. sec. 710 (c) (3) uses the term "taxpayer" only at its beginning. The word "owner" has been liberally construed to include a parent corporation taking possession of and operating vessels belonging to subsidiary corporations.⁵⁷ Moreover where a subsidiary corporation paid a processing tax but included the amount in its invoice of the product to the plaintiff and was later merged into the plaintiff, it was held that the plaintiff could recover a refund of the processing tax paid under the invalid A. A. A. act.⁵⁸ The statutes of the state of incorporation frequently provide that upon a merger or consolidation a new corporation comes into existence. Whether or not a new corporation comes into existence has been held to be a matter of local law and the agreement of the parties. Many cases have held that if under the statutes of the state of incorporation of the successor corporation a new corporation comes into existence, such new corporation may not take a net loss deduction.⁵⁹

⁵³New Colonial Ice Co. v. Helvering, (1934) 292 U. S. 435, 54 S. Ct. 788, 78 L. Ed. 1348.

⁵⁴New York Central R. Co. v. Com'r, (1935 C.C.A. 2) 79 F. (2d) 247, cert. denied (1935) 296 U. S. 653, 56 S. Ct. 370, 80 L. Ed. 465.

⁵⁵New Colonial Ice Co. v. Helvering, (1934) 292 U. S. 435, 54 S. Ct. 788, 78 L. Ed. 1348.

⁵⁶(1931) 22 B. T. A. 97, 103.

⁵⁷Munson S. S. Line v. Com'r, (1935 C.C.A. 2) 77 F. (2d) 849.

⁵⁸Interwoven Stocking Co. v. U. S., (1944 C.C.A. 3) 144 F. (2d) 768.

⁵⁹General Finance Co. v. Com'r, (1936 C.C.A. 3) 85 F. (2d) 846; General Gas & El. Corp. v. Com'r, (1938 C.C.A. 2) 98 F. (2d) 561; Jones v. Noble Drilling Co., (1943 C.C.A. 10) 135 F. (2d) 721.

As an original proposition it would seem that the bond discount analogy might persuade the courts to alter the net loss deduction rule. The rule protecting the successor corporation in bond discount cases was laid down in 1939 in *Helvering v. Metropolitan Edison Co. v. Com'r.*⁶⁰ five years after the net loss decision in *New Colonial Ice Co. v. Helvering*.⁶¹ While the Supreme Court has not ruled on the validity of the analogy, about fifteen decisions between 1929 and 1944 of the federal circuit courts and of the tax court have rejected the analogy.⁶² Usually the rejection of the analogy is placed on the ground that the net loss statutes use the phrase "of the taxpayer." It has also been placed on the ground that in the bond discount cases no loss was sustained by the issuing corporations in selling their bonds at a discount, and that the loss will in reality be sustained by the consolidated corporation when the bonds mature and are paid. The deductions are thus by way of the successor corporation's own loss. The successor corporation is not attempting to benefit by a deduction of the predecessor arising from the predecessor's previous operations, but is seeking to deduct an amount to meet an obligation which the taxpayer itself had assumed by operation of law rather than by purchase. The leading Supreme Court decision on bond discount, *Helvering v. Metropolitan Edison Co.*,⁶³ has been distinguished as being based, not on any issue of dissolution or continuance of the old company, but on the successor corporation's becoming liable for the obligations of its subsidiary by operation of law. It has also been stated that in the bond discount cases the element of carry-over from one taxable period or one taxable entity to another is not present.⁶⁴ The bond discount analogy was applied to a net loss deduction in *Industrial Cotton Mills Co. v. Com'r.*⁶⁵ A dictum thought it applicable in *Brandon Corp. v. Com'r.*,⁶⁶ as did a dissent in *Standard Silica Co.*⁶⁷

The conclusion that appears warranted by the foregoing discussion is that the likelihood that the surviving corporation will be held entitled to use the deductions and credits of the merged cor-

⁶⁰(1939) 306 U. S. 522, 59 S. Ct. 634, 83 L. Ed. 957.

⁶¹(1934) 292 U. S. 435, 54 S. Ct. 788, 78 L. Ed. 1348.

⁶²*The Maytag Co. v. Com'r.*, (1929) 17 B. T. A. 182; *Athol Mfg. Co. v. Com'r.*, (1931) 22 B. T. A. 105; *New York Cent. R. Co. v. Com'r.*, (1935 C.C.A. 2) 79 F. (2d) 247; *Jones v. Noble Drilling Co.*, (1943 C.C.A. 10) 135 F. (2d) 721; *Marion Reserve Power Co. v. Com'r.*, (1943) 1 T. C. 513.

⁶³(1939) 306 U. S. 522, 59 S. Ct. 634, 83 L. Ed. 957.

⁶⁴*Marion Reserve Power Co. v. Com'r.*, (1943) 1 T. C. 513.

⁶⁵(1932 C.C.A. 4) 61 F. (2d) 291.

⁶⁶(1934 C.C.A. 4) 71 F. (2d) 762.

⁶⁷(1931) 22 B. T. A. 97, 103.

poration is rather slight.⁶⁸ On the other hand when consolidated returns are filed in successive years the fact of merger has no legal significance.

⁶⁸See also 5 Mertens, *The Law of Federal Income Taxation*, (1942), Sec. 29.11, pp. 335-339; J. K. Lasser, *Reorganization and the Excess Profits Tax*, (1944) 20 N. Y. U. Law Quar. Rev. 23, 38; L. H. Dwyer, *Carry-Back Refunds and Post-war Plans*, (1944) 22 *Taxes* 355.